UNITED STATES SENATE
REPUBLICAN
POLICY COMMITTEE

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June 13, 2002

Terrorism Insurance and Premiums

As the Senate debates the terrorism reinsurance bill, it would be prudent not to oversell its benefits. While we hope a federal backstop will help the economy and prepare markets for another attack, it would be unwise to claim that a federal terrorism insurance law will drive down insurance premiums in general. It won't. By most accounts, businesses and property owners will continue to pay dramatically higher insurance premiums long after a terrorism reinsurance bill is enacted.

Earlier this year, private industry advocates of federal terrorism insurance released talking points that listed high-profile properties and construction projects facing dramatically higher insurance premiums. The point was to illustrate that property owners were paying substantially higher premiums for property and casualty insurance. Here is an example:

> Events of September 11 Caused Major Insurance Industry Losses: Estimates range from $36 billion to $54 billion. As a result, the reinsurance industry (not legally obligated to cover terrorism) has generally stopped covering terrorist acts. Forty-five states (covering about two-thirds of commercial insurance) have allowed primary insurers to also exclude acts of terrorism from property and casualty coverage. Even with the state exclusions, <u>premiums for property and casualty insurance increased approximately 30 to 50 percent in the wake of the attacks</u>.
>
> – Coalition to Insure Against Terrorism

This example confuses property and casualty insurance that *covers* terrorist acts with insurance that *excludes* terrorist attacks. The impression is left that passage of federal terrorism insurance legislation will target coverage that doesn't include terrorist attacks and drive down all property and casualty rates.

The reality is that premiums for *all* property and casualty insurance policies are rising, even those that *exclude* coverage for terrorist attacks, and they started rising well before 9/11. Insurance premiums are rising for three primary reasons:

- First, rates of return for insurance company reserves have been declining with the stock market for the past two years.

- Second, insurers wrote very aggressive policies during the 1990s that have had higher than expected costs.
- And third, the loss of \$30-60 billion in reserves from the attack of September 11th lowered those returns further.

Here's an excerpt from the *Wall Street Journal* (4/11/02) on the issue:

> The higher premiums many small and midsize businesses hundreds of miles from New York City now face are the legacy of a decade of imprudence among insurers – a period that combined a relentless price war with aggressive risk-taking. From 1993 to 2000, underwriters slashed rates, sometimes as much as 40 percent, and fought for customers by loosening terms on all types of business policies – from directors-and-officers' liability coverage to medical-malpractice packages to workers' compensation insurance….
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> Insurers eventually reached the limit. By 1999, they were paying out, on average, \$1.07 in claims and related expenses for every \$1 of premium received on business coverage. During the bull market of the '90s, insurers could sustain these losses on underwriting because the shortfalls were more than offset by investment income the insurers earned on premiums.
>
> Now financial markets have soured, and so have insurers' investment yields. The companies have also been hurt because claims on the cheap policies they wrote in recent years have come in much higher than they originally estimated – optimistically, in the eyes of some critics. And all this was happening before Sept. 11.

The General Accounting Office (GAO) made the same point:

> Prices were already increasing for commercial coverage prior to September 11th. Industry participants have told us that the increases were part of the underwriting cycle normal in this insurance market. Industry losses from the terrorist attack almost certainly exacerbated the rise in prices, as any major catastrophe would have. [GAO Testimony, House Committee on Financial Services, 2/27/02]

The point is underscored by other observers as well:

> But analysts at Standard & Poor's said that while the events of Sept. 11 accelerated the increase in U.S. commercial real estate insurance premiums, property and casualty insurance costs had already begun rising in 2000, independent of terrorism-coverage costs. [*Insurance Chronicle*, 5/20/02]

> Global property and casualty rates were already on an upward trend before September 11, as insurers realised that they could no longer rely on investment returns to conceal years of poor underwriting. [*Financial Times* (London), 5/24/02]

A temporary federal reinsurance program may help restore confidence in the economy and certain industries, but it should not be oversold. Federal terrorism coverage will do little or nothing to reduce insurance rates for insurance coverage that doesn't cover terrorist acts. It probably won't help those properties and businesses that already have terrorism insurance. As far as premiums go, only those properties and businesses that have resisted buying terrorism insurance to this point are the clear winners under S. 2600.

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